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FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, DC 20554

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July 30, 1997

EXP. DATE ON DATE FILED

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, DC 20554

RE: Notification of Oral Ex Parte Communication: Access Charge Reform -
Pricing Flexibility
CC Docket No. 96-262

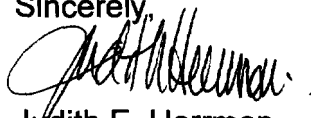
Dear Mr. Caton:

Yesterday, on July 29, 1997, J. Manning Lee, Vice President - Regulatory and External Affairs and I met with Rich Lerner, Jay Atkinson, Dana Bradford, Paul Glenchur, David Konuch of the Competitive Pricing Division, and Jeffrey Lanning of the Competition Division to discuss the Commission's proposed market-based access charge pricing flexibility reforms. The topics addressed during the discussion followed the outline attached.

An original and one copy of this letter are being submitted in accordance with Sec. 1.1206(b)(2) of the Commission's rules.

Thank you very much for your assistance in this matter.

Sincerely,



Judith E. Herrman
Manager, Federal Regulatory Affairs

cc: Rich Lerner
Jay Atkinson
Dana Bradford
Paul Glenchur
David Konuch
Jeffrey Lanning

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MARKET-BASED DEREGULATION OF ILEC SWITCHED ACCESS PRICING

***Teleport Communications Group Inc.
July 29, 1997***

DISTINCT SWITCHED ACCESS SERVICE "MARKETS" HAVE DIFFERING COMPETITIVE CHARACTERISTICS

End Office Switching Services

- Section 271 checklist items, and the presence of facilities-based business and residential customers, provide a reasonable test for when competition for end office switching services is feasible such that further deregulation can be considered.

Tandem Transport and Switching Services

- Tandem services will only begin to face competition when ILEC tandem switching prices are moved to full cost -- a process that will not be completed until January 1, 2000 when the final TIC subsidies are removed.
- These services only face competition when sufficient, cost effective physical collocation arrangements are in place to offer alternative paths to the end office, and when all necessary billing and signaling arrangements between ILECs and CLECs are in place for tandem competition.
- Relaxed regulation of these services must await final steps in FCC access charge plan and demonstration that permanent, irreversible competition exists in the market.

Dedicated Transport Services

- These services have already been largely deregulated by prior Commission orders, allowing volume and term discounts and zone pricing.
- Pricing flexibility was originally granted based on presumption that physical collocation would introduce competition -- relaxed regulation was not toned down when physical collocation was terminated, so present relaxed regulation is certainly sufficient.
- The lack of affordable and cost-based physical collocation acts as a bar to effective competition for dedicated transport.

PHASE I - POTENTIAL COMPETITION

INITIAL, LOW-THRESHOLD TRIGGERS WARRANT ONLY MINIMUM PRICING FLEXIBILITY

- **Competition can only develop if pricing flexibility is “proportionate to” the level of competitive entry.**
 - **Substantial pricing flexibility that does not reflect the actual level of competition will encourage the ILECs to engage in predatory pricing against their competitors.**
 - **Initial, low-threshold triggers for Potential Competition should mirror the interconnection *obligations* of Sec. 251 and must enable rapid provisioning of network elements and wholesale services consistent with demand levels.**
- **Unbundled Network Elements are an untested substitute for ILEC switched access and should not be relied upon to provide any competitive pressure on ILEC switched access pricing for end office elements.**
 - **If permanent UNE rates approximate or mirror switched access rates, then no competitive alternative is really being offered.**
 - **Ability of UNEs to provide effective competitive pressure cannot be assessed until permanent UNE rates satisfy TELRIC and until all OSS issues are resolved and systems are demonstrably working.**
 - **Effectiveness of UNE-based competition may be seriously impacted by the 8th Circuit ruling relieving ILECs of obligation to “combine” UNEs.**
- **Performance reporting requirements offer credible, reliable evidence that demonstrate whether the Potential Competition threshold has been met.**
- **Contract tariff pricing and individual RFP responses offer ILECs substantial deregulation beyond the level appropriate for the low-threshold triggers for Potential Competition.**
 - **Competition – not untimely, substantial deregulation – will best protect ILEC non-contract customers from ILEC overpricing by offering higher quality, better-priced service.**

PHASE II - PERMANENT, IRREVERSIBLE COMPETITION

PERMANENT REMOVAL OF TIC SUBSIDIES AND SEC. 271 CHECKLIST COMPLIANCE PROVIDE THE FRAMEWORK FOR ADDITIONAL PRICING FLEXIBILITY

- All subsidies first must be completely removed from access elements before permanent, irreversible facilities-based competition can take root.
 - For example, because the TIC subsidizes ILEC switching and transport elements, facilities-based competition can not take hold until the ILECS can no longer price switching and transport below their cost.
- Performance reporting requirements offer credible, reliable evidence that demonstrate whether the Permanent, Irreversible Competition threshold has been met.
- Evaluation of Phase II competition on a service-by-service basis must take into consideration risk of cross-subsidization by the ILECs, between less competitive and more competitive elements.
- Elimination of the transport and local switching rate structures and consolidation of the distinct traffic-sensitive and trunking baskets is premature and would thwart effective, facilities-based competition.
 - Competition in tandem transport/switching and local switching will not develop at the same time -- competitive characteristics of the two markets are very different.
 - Effective and substantial local competition will only occur when CLECs can install local switching facilities to obtain access to their own end user facilities or to unbundled loops -- until such access is widespread.

PHASE III - SUBSTANTIAL, EFFECTIVE, COMPETITION

SUBSTANTIAL DEREGULATION OF ILEC SWITCHED ACCESS IS WARRANTED ONLY AFTER MARKET ENTRY MEASUREMENTS SHOW SUBSTANTIAL, EFFECTIVE COMPETITION

- **Substantial competition can only exist if, at a minimum, there is effective enforcement and widespread development of facilities-based competitors.**
- **Effective enforcement mechanisms require penalties and punishment should an ILEC fail to maintain compliance with triggers to earlier pricing flexibility.**
- **Substantial deregulation must be proportionate to the level of market entry.**
- **Once substantial and effective competition has developed, substantial deregulation -- contract tariff pricing, RFP responses, deregulation of transport and local switching rate structure and consolidation of pricing baskets -- can be implemented.**

ILEC Deregulation Should Parallel Competitive Levels

